UNITED STATES OF AMERICA

BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Conference on Competition in Wholesale Power Markets

Docket No. ADO7-7-000

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February 27, 2007

Panel 2
Today's Challenges in Strengthening Organized Markets

I would like to thank the Commission for the opportunity to participate in this Conference. The topic of our panel is strengthening organized RTO markets. I approached this issue from the perspective of a smaller, load-serving entity that has an obligation to provide long-term service to our members, and through our members to their retail customers. We regard electric service as an essential public service. Our objective is to provide highly reliable electricity at a stable, competitive and affordable cost over the long term for our residents and to keep our industries competitive. To do so, we need to develop and maintain a diverse portfolio of power supply resources and to aggressively pursue energy conservation and efficiency measures to meet the supply and environmental challenges that our industry faces. The question is how the organized markets help or hinder us in achieving these objectives. We strongly support wholesale competition.

WPPI is primarily a participant in the MISO market where most of our load and resources are. We also participate in PJM, where we have some generation. Our experience with MISO is a mixed bag. There are certainly some positives. We believe the grid is more reliable when operated by a single entity with a large footprint that has a wide view of the system. We have found MISO responds more quickly to unplanned outages and minimizes disruption resulting from such outages. There is greater price transparency in short-term markets and efficiency pressure on the availability of units. MISO offers the potential of lower reserve requirements if the market is supported by a robust transmission system.

There also are a number of problems related to the questions asked of this panel relating to organized markets. First, I do not believe that the Day 2 Market design is effective in getting needed new transmission or base load generation built to provide long-term adequacy and least-cost supply. Long-term contracts have become harder to get and, in some places, they are simply not available. In addition, LMP markets create significant stakeholders in preserving congestion, which can substantially delay solutions that would much benefit customers.

Frankly, I think that 95% of the benefit of organized markets can be achieved through a Day 1 RTO with a balancing market, much like SPP, at significantly less cost than we are experiencing.

In addressing market issues, I would urge the Commission to step back and thoroughly assess the results to date. This Commission did not drive the creation of Day 2 Markets and has indicated a willingness to pause and take a hard look at the experiments that have gone before. We need a credible, detailed assessment of the costs and benefits of these markets, not dueling studies commissioned to provide justification for various interests. The key question that needs to be answered is whether there are net benefits for end-users — for retail customers — from the organized markets. This is not an easy question to answer. Certainly, the formation of these markets and their operations are costly. However, it also is clear that regional economic dispatch should be more efficient and should bring cost savings compared to individual utility dispatch.

To the extent that LMP markets achieve regional economic dispatch, they should bring those benefits — but at what off-setting cost? This is a very important question to customers and to state regulators.

It also is clear that there are big winners and there are losers in RTO markets. If you are an entity that owns a nuclear power plant for which stranded costs have been paid by customers through state deregulation regimes and you are now able to receive a gas price for many hours of the year and a coal price for the rest, the market clearly works very well for you. But that does not tell me whether benefits flow through to consumers. Also, Day 2 markets have created a new business in the buying and selling of FTRs unrelated to any load-serving obligations and complicated systems to arbitrage projected price differences based on LMPs. These new players take money out of the market. Whether they provide benefits or not is an open question. Our initial analysis suggests that load subsidizes these players substantially.

The American Public Power Association (APPA) has recently commissioned a series of studies critiquing the cost-benefit analyses done to date of retail competition and organized markets. The conclusion of the APPA studies is that there are some very serious questions as to the rigor of the analyses to date and the accuracy of the conclusions. I would urge FERC to review the APPA critiques very carefully. This agency has both the responsibility and the expertise to move forward to credibly determine what the extent of consumer benefits really are, if any.

In this regard, MISO has been struggling with a cost-benefit study for some time, which has been much delayed. It is my understanding MISO has recently released preliminary results for the first 10 months of its operations that show benefits significantly lower than anticipated and it is not at all clear that these benefits have been offset in the calculation by the costs of obtaining them. Presumably, the benefits will increase over time; start-up is more expensive than continued operation. Nevertheless, the issue of whether net benefits will be achieved for end-users remains a very important, unanswered question.

I note that the questions for the third panel today on bilateral markets apply very much to WPPI's concerns, such as obtaining long-term transmission access, resource planning, etc. It appears implicit in the questions for the current panel and the bilateral panel that there is an underlying assumption that organized markets interface with retail deregulation and bilateral markets interface with regulated jurisdictions. While the second conclusion may be correct, the first is not. At least half of the states in the MISO have not deregulated and are not likely to. In Wisconsin, all utilities have a long-term obligation to serve. There is rate base recovery for virtually all generation and there is no merchant generation not under long-term contract to LSEs. It makes no sense whatsoever to argue that scarcity pricing is necessary or appropriate to get new facilities built where capacity costs are recovered in rate base. I believe much of MISO's difficulty in reaching consensus results from having a number of states with deregulated retail markets and a number of states that remain regulated with rate base cost-of-service regimes. To think that one set of rules can apply fairly, and one set of economic assumptions can be used to govern those rules, in this situation, is unrealistic and harmful.

I would also point out that in states that have deregulated, municipal utilities and coops have, for the most part, opted out and are essentially functioning as utilities function in regulated states. This is in part why the rules being developed in the RTO markets do not work for them. Also, a warning —as states shifts away from retail deregulation back to regulated retail service for residential customers, this mismatch will only increase.

We have been asked to address specific improvements that can be made to organized markets. I have several suggestions.

1. Governance. There is a tension between the concepts of independence and accountability. I vote for more accountability. I have experience on a hybrid board at American Transmission Company and I think the system works very well. It is the utility owners who pay the bills that often ask the hard questions of management. I believe that RTO governance would benefit significantly by having a minority of Directors on the Board elected by the stakeholder group as a whole, so that some of the people who actually pay the bills, and are affected directly by RTO decisions, are part of the decision-making process.

2. Long-Term Rights. I would like to thank the Commission for moving promptly to implement the Energy Policy Act provision on long-term transmission rights through FERC's new rule. Long-term transmission rights are absolutely essential in RTO markets for those of us who have long-term obligations to serve. We need the security of long-term transmission rights to plan and build generating units and to realize the cost benefits that justify those units. FERC has done an excellent job in its rule. Now it needs to be implemented fairly and rigorously in the individual RTOs.

However, there is an essential next step: that is to require RTOs to plan the grid to meet the simultaneous feasibility test both for existing resources dedicated to load and for new generation resources for which long-term rights are to be made available. If those rights are subject to the risk of substantial pro ration in the future because the system has not been planned to meet the simultaneous feasibility test, the rights will not serve their purpose and will be of much, much less value.

3. A Robust Grid. The top priority for RTOs should be the development of a robust transmission infrastructure to make markets work. Strong transmission solves many, many problems, including price volatility and opportunities for difficult-to-detect market manipulation. Transmission facilitates the ability to plan new resources and eliminates much of the complexity and outsourced regulation that is occurring in RTO markets as a result of congestion. RTO market proponents trumpet the ability to hedge, but where there is significant congestion those who offer hedges are not present.

To achieve a robust transmission system, we should get rid of the distinction between "economic" and "reliability" facilities that just creates argument and delay. Virtually every transmission facility that is built will have reliability benefits and as time goes on, those reliability benefits are likely to increase as load grows. We need an infrastructure that provides excellent reliability and makes the market function well. That should be a single objective.

We also need to get away from the idea that every transmission facility must compete against conservation and efficiency improvements and generation plant additions. This is not to say that energy conservation and efficiency is not important. My view is that we should be doing everything we can in these areas. It is the least expensive way to serve load over the long term, reduce customer bills and keep industry competitive. We also need a robust transmission system for the markets that will work for consumers. It is not an either or choice.

In this regard, we need to recognize that much of new generation that is needed will not be built near load. We need robust transmission for renewables to get to market and to locate base load plants where they can be sited. The system needs to be built to support these additions.

4. Regional Rates. The Commission needs to bite the bullet and pursue regional rates that provide significantly greater cost-sharing for backbone, high voltage transmission than is occurring today. If we wait for areas with low transmission costs to agree, we will never get a strong regional system built. Minimal cost-sharing for the high voltage system will result in a sub-optimal transmission system. In the long term, everyone needs to recognize that construction is going to be required everywhere, that vigorous wholesale competition will benefit everyone over time and that the relative beneficiaries will change. Resolving the cost-sharing issue is extremely important to getting facilities built. We bit the bullet in Wisconsin in the formation of ATC. Over five years we have averaged rates and a number of us, including WPPI, had our costs go up because our load was located primarily on the lowest-cost system. We did it because we recognized that the long-term benefits of a strong grid outweigh the short-term benefit of a lower rate.

5. **LMP Limitations**. Finally, it is very important that in seeking to improve markets, the Commission recognize the limitations of the LMP system. It does not solve all problems. LMP pricing will not drive the construction of new, major transmission or generation facilities. In fact, LMP price signals create major stakeholders in congestion and scarcity pricing, who have the potential to block and delay needed improvements.

Our experience is that facilities are getting built for other reasons. In Wisconsin, we have major transmission construction underway that began well before the Day 2 Market. It is the result of restructuring the ownership of the grid with a transmission-only company that has to build in order to grow, has a single focus and cannot shy away from transmission because it is politically unpopular to site. Also, FERC’s decision to allow a formula rate, with recovery of pre-certification and CWIP has been very helpful.

In Minnesota, the CapX 2020 group is moving forward with substantial transmission construction. Major driver include (i) a change in state law based on what FERC has done with

CWIP and pre-certification for ATC, so that cost recovery is more certain and (ii) a highly inclusive process that allows all the load-serving entities to participate in the planning, construction and ownership of the system, building broad political support and needs justification. LMP pricing has not, to my knowledge, been discussed at all, although the limited regional cost-sharing of the current MISO tariff, which is a Day 1 tariff matter, has been helpful.

On the power plant side, we have to build wind where there is wind and that is not driven by LMP prices. Nuclear units are going to be difficult to site. They will not be at load centers. LMP tells you to build at the load.

Coal plant siting is driven by a variety of factors that are much more important than LMP congestion costs, particularly, since we cannot possibly predict accurately what congestion will look like five or seven years from now when a plant is actually built and put into service. The key factors are water, competitive coal transportation, where a facility can be permitted from an air and water perspective, the extent of local support and whether the geology is present for potential carbon sequestration. Another key factor, if you look at Wisconsin and Iowa where base load plants are being built, has been state laws providing certainty of cost recovery over the long term for plants that take five to seven years to build, as opposed to gas. Without this cost support certainty, LMP pricing would produce only gas-fired plants. We would not get needed fuel diversity and we certainly would have a sub-optimal system for the long term.

Finally, I am particularly concerned with the notion that all we need is to lift price caps and have high scarcity pricing in order to get facilities built. I do not think that bankers will lend on major projects based on scarcity prices today and projections of what congestion costs may be five to seven years from now. Our experience is that wind cannot be done without long-term contracts that allow the developers to buy the turbines. Coal projects require long-term contract commitments, or ownership arrangements, in order to move forward. In contrast, stronger demand response programs can certainly help resolve price spikes and mitigate market power.

The advocates of scarcity pricing seem to fall into two categories. First are those entities that benefit significantly from price spikes and scarcity pricing because of the location of their existing generation and its fuel type. There is no mystery as to why scarcity pricing looks good to those who will receive a windfall. The other proponents are academics who live in a model world and not the real world where we operate. This brings to mind an article I recently read in the *New York Times* where a bunch of economists got together and agreed that, clearly, the most efficient gift for Valentine's Day is cash. Well, I strongly suspect there might be unanticipated consequences from pursuing the god of efficiency in that circumstance. Similarly, telling states, particularly states that operate in a regulated environment with an obligation to serve, that what we really need is much higher prices to achieve adequacy is a non-starter.

Thank you.

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